



**TOM WELCH**

Associate Broker  
GRI - Graduate Realtor® Institute  
CDPE - Certified Distressed Property Expert™

direct 202.422.6500  
fax 202.423.6500  
tom@tomwelch.net  
www.tomwelch.net

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# COOPERATIVELY SPEAKING

A history of Cooperatives in Washington DC  
and a guide to understanding the Cooperative  
as a form of home ownership.

## **COOPERATIVELY SPEAKING**

**William M. Karas, President**  
**Edmund J. Flynn Company**  
**Coop Specialists Since 1920**

### **Company Background**

A strong sense of history and continuity defines the Edmund J. Flynn Company.

The company's origins go back to 1920 when Mr. Flynn pioneered the concept of cooperative ownership in Washington, D.C. Since then the company has participated in the development of more than 40 cooperative projects.

Since its beginning, the Edmund J. Flynn Company has been true to its heritage by maintaining a close identity with and support of cooperative ownership.

Although some of its business activities have changed over the years, the Flynn Company continues to provide settlement services to coop buyers as well as Transfer Agent services to most of the cooperatives located in the Washington, D.C. metropolitan area. As Transfer Agent, the Flynn Company prepares the ownership records when there is a transfer of ownership and maintains those records on behalf of the cooperative corporation.

Today, as always, the Edmund J. Flynn Company is ready to render its expert services to cooperative associations as well as to coop owners and buyers alike.

**William M. Karas**  
**President**

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## Cooperatives organized by the Edmund J. Flynn Company since 1920

The Hoyt\*  
Dumbarton Court  
The Netherlands  
Rutland Court  
Cavanaugh Court  
The Adelpia\*  
The Stafford  
The Lambert  
1705 Lanier Place  
Cleveland Park Apartments  
The Porter  
3407-9-11 Twenty Ninth Street  
55 M Street\*  
65 M Street\*  
66 New York Avenue\*  
76 New York Avenue\*  
1201 First Street\*  
The Clydesdale  
Hampshire Gardens  
3810 Southern Avenue\*

The Broadmoor  
The Avondale  
Meridian Hill Apartments  
1702 Summit Place\*  
Potomac Plaza Apartments  
Potomac Plaza Terraces  
Frances Cariton in Sarasota, Fl.  
The Mendota  
The Ontario  
Kenwood House in Chevy Chase, MD  
Woodley Gardens in Rockville, MD  
The Presidential  
Harbour Square  
Hamlet Place in Chevy Chase, MD  
The Saxony  
The Norfolk  
2800-2802 Devonshire  
1860 California Street  
Winchester-Underwood  
Madison Terrace

\*No longer exists

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## **PART ONE**

### **D.C. Cooperatives: A Historical Perspective**

Cooperatives have existed in the Washington area as a form of home ownership since 1920; there are approximately 120 cooperatives in the District alone. Yet, in spite of their long-term popularity, cooperatives are the least understood form of residential home ownership.

One possible reason why cooperatives are not a more familiar form of ownership is due in part to their highly urban locations. New York, Chicago and D.C. are some of the cities where cooperative associations have flourished for decades. Condo associations, on the other hand, are located in both urban and suburban areas. Consequently, buyers are more familiar with the condominium concept, but this was not always the case.

### **Condo vs. Coop**

When condo apartments were first introduced in the Washington area during the 1960's, would-be buyers raised thoughtful questions about the condominium form of ownership—mainly, its organization and function.

Many are unaware as to how the condominium form of ownership was created. A creature of legislation, the condominium uniquely combines fee simple or real property ownership for each individual apartment unit together with an undivided interest in all the common areas and facilities of the association. Generally speaking, common areas are public spaces outside of one's apartment unit such as hallways, basements, pools, land, etc. Each unit owner's interest in the common areas is undivided and indistinguishable from any other unit owner's interest. All the condominium unit owners as tenants hold the common areas and the land on which the building stands in common. Legislation states that individual ownership of a condominium unit constitutes an interest in real property.

Ownership of a cooperative unit, on the other hand, is generally considered an interest in personal property because the cooperative corporation has fee simple title or real property ownership of the entire property. This corporation, in turn, grants each member or owner the "right" to occupy a unit: herein lies the most significant difference between cooperative and condominium ownership. One's ownership interest in the corporation and the right to occupy a unit is considered an ownership interest in personal property and not in real estate. However, the daily operation of cooperatives and condominium associations is quite similar.

## **The Corporation Factor**

Cooperatives have never required any special legislation to give rise to their existence; corporations can be formed for a number of legitimate purposes. Simply put, a cooperative is a corporation formed for the purpose of providing housing for its members or owners.

In 1920, Edmund J. Flynn in association with Alan E. Walker pioneered the cooperative form of ownership, as it is known today in the Washington, D.C. area. The plan was novel, providing for 100% cooperative ownership as opposed to the common practice of selling only a portion of the building and placing the balance under rental.

The first cooperatives were organized, as they still are today, in the form of a corporation that typically holds fee simple title to the entire property. Some cooperatives own the building while leasing the land. Conceivably, a cooperative corporation could lease a residential building for occupancy by its members.

Two instruments evidence membership in the corporation: a stock certificate and a proprietary lease. Shares of stock are issued to show the value relationship of one unit to the other and to pro-rate the corporate mortgage payment if any, the operation and maintenance expenses, and the property's real estate taxes.

The proprietary lease spells out the relationship between the owner members and the corporation. It contains many of the same clauses that are found in a residential lease but also refers to those special provisions distinguishing an apartment unit owner from a tenant, such as the owner's right to participate in corporation affairs, vote or have the use and enjoyment of the unit indefinitely.

The Charter and By-Laws, which all corporations adopt, are the cooperative's governing documents that describe the relationship between the individual cooperative owners. They cover items such as how to liquidate the corporation should the membership ever decide to dissolve it, how to elect the board of directors, how to vote, when to hold annual meetings, and the like. The Charter and By-Laws vest in the Board of Directors the authority to run the building, establish policies, approve new buyers or renters, develop an operating budget and contract for services.

With the sale of the Broadmoor Apartments in 1948, a new form of cooperative was introduced to Washington, D.C. In order to avoid the complex requirements of registration with the Securities Exchange Commission, the cooperative, although still a corporation, no longer issued stock but rather became a membership form of cooperative. In place of stock and proprietary leases, one document was issued which, in the case of The Broadmoor, was termed a "Perpetual Use and Equity Contract." The name has come to vary from one cooperative to another, sometimes called a Cooperative Ownership Contract and sometimes an Ownership Contract. Regardless of the name, the document is substantially the same in most membership cooperatives.

The Ownership Contract combines into one instrument most of the provisions that were previously contained in two separate instruments: the stock and lease. The Ownership Contract differs from the earlier stock cooperatives, however, in that it provides, in most cases, for one vote per unit rather than one vote per share in stock. Thus, small and large apartments acquire equal voting rights, bringing the cooperative even closer to the democratic concept.

The Nitty Gritty Simply stated, a housing cooperative is a corporation, owned and operated by its members and formed to provide housing for said members. All housing cooperative property is actually owned in the name of the corporation, which is directly responsible for the monthly payments of principal and interest on any corporate mortgage indebtedness, the payment of real estate taxes on the corporate property and for any other operating costs such as insurance, service contracts, salaries and the like.

Individual members (also known as owners or stockholders), by virtue of their ownership interest in the corporation, have the right to occupy their dwelling unit, participate in the operation of the cooperative corporation and have an obligation to pay their proportionate share of the cooperative's annual operating budget.

If a member fails to pay his pro-rata share of the cooperative's budget, the other members, acting through the cooperative, are required to pay the deficiency. This is one reason for providing an operating reserve. However, the cooperative has a lien on each member's Ownership Documents and ultimately has the right to sell the defaulting member's apartment unit in order to recover the defaulted payments.

Its Certificate of Incorporation and its By-Laws govern the cooperative's operation. These documents give each owner the right to annually elect the Board of Directors. The Board is charged with managing the business affairs of the cooperative and supervising the operation of the cooperative's physical plant. Day-to-day management is generally delegated to a property management firm selected by the Board. The Board adopts the annual budget, which contains estimates of the association's operating costs for the coming year. The budget is the basis for establishing the monthly fees charged to each member. The Board also has the authority to establish, amend and enforce the House Rules, which, in conjunction with the Ownership Documents, govern the use and occupancy of the property.

## **PART TWO**

### **Cooperative Financing**

For nearly 60 years after Edmund J. Flynn organized the first cooperative in 1920, bank financing was not available to coop buyers. D.C. banks, organized under Federal Charter, were not authorized to loan money secured by a pledge of a borrower's ownership interest in a coop. This lack of financing adversely affected not only the value but also the marketability of coops.

This situation changed in 1979 when the Federal Home Loan Bank Board issued its final regulation authorizing federal savings and loan associations to make loans on individual coop units. That same year the principals of the Edmund J. Flynn Company convinced American Security Bank to develop a pilot loan program for financing coop resales. Harbour Square, a cooperative located on the waterfront in Southwest D.C., was eager to participate in the development of such a loan proposal. This was the first time a D.C. lender entered into a formal arrangement, called the Recognition Agreement, with a coop association to provide purchase money for financing resales.

Although American Security's pilot loan program was short-lived due to market acceptance, high interest rates and a \$50,000 loan limit, this first D.C. area cooperative loan program became the basis for future participation by other lenders. As a result, bank financing for Washington coops began.

### **The Loan Process**

Applications for coop loans are underwritten in the same manner as applications for any residential loan. Lenders follow the underwriting guidelines prescribed by the secondary lending market, typically Fannie-Mae.

A lender will verify sources of income and confirm the borrower's financial obligations including installment debt, student loans, alimony/child support, and investment property. The lender will then obtain the borrower's credit report from a consumer credit reporting agency. The next step is the coop unit appraisal, which is performed by an appraisal firm that has been approved by the lender. The borrower pays for costs for the credit report and the appraisal either separately or as part of the lender's application fees (check with your lender).

The lender may require a report of termite inspection prior to settlement depending on the type of unit, i.e. townhouse, or the location of the unit relative to the ground in a multi-family building. The report is ordered and paid for by either the seller or the purchaser/borrower as stipulated in the sales contract.

Hazard insurance, which covers the replacement value of the unit, is generally not a requirement because the replacement value of the unit being financed is covered by the cooperative corporation's master insurance policy. The lender, however, will require the settlement officer to obtain a certificate of insurance from the coop's insurance carrier verifying such coverage.



Typically, there is no title search performed on the unit because the ownership interest in a coop unit is considered personal property. Any transaction involving the transfer of personal property is not recorded among the land or real property records in the Recorder of Deeds office.

It is, however, common practice for a lender to have the settlement office order a search for the non-land or chattel records in the Recorder of Deeds office to determine if there are any issues which encumber the seller’s ownership interest in the unit or affecting the credit worthiness of the borrower.

Lastly, there is no survey requirement because no land or real estate changes hands in the transfer of a cooperative unit.

**The Loan**

It should be noted that, in the Washington, D.C. area, the price quoted for a cooperative unit is the full price, which includes the allocated portion of any corporate or blanket mortgage financing. Since the price of a coop unit includes the unpaid share of the blanket mortgage allocation, the current balance of the blanket mortgage is included in the total financing permitted by a lender (see example below).

Coop unit financing differs among the participating lenders since there are a variety of home loan programs from which to choose. Each lender has minimum down payment requirements, maximum loan amounts, different repayment schedules and loan fees. In addition, some coops have minimum cash down payment requirements. Not every lender offers coop financing. Among the lenders that do, not all have a Recognition Agreement with each and every cooperative association. Check with the lender or with the coop’s management.

**Financing a Coop Unit (simplified example)**

Purchase Price	\$100,000.00
Present Corporate Mortgage Allocation	<u>- 25,000.00</u>
Seller’s Equity	\$75,000.00

Lender’s loan is based on the equity value.  
 For example, if lender will finance 80% of the unit’s equity value:

Equity Value	\$75,000.00
	<u>          x80%</u>
Loan Amount from Lender	\$60,000.00

Therefore, at Closing:

Lender’s Loan	\$60,000.00
Blanket Mortgage	+25,000.00
Cash Payment	<u>+15,000.00</u>
Purchase Price	\$100,000.00

## **Recognition Agreement**

The loan documents for coop unit financing are akin in principle to those needed to perfect a lien on real property: a note states the loan amount, rate of interest, payment schedule, etc. Also a security agreement outlines the borrower's obligations to repay the loan and the circumstances leading to foreclosure in the event that the borrower defaults in his or her obligations to the lender or to the coop.

The single document that is absolutely unique to coop unit financing is the Recognition Agreement. The borrower, an officer of the coop association and an officer of the lender sign this pre-approved form at the time of settlement.

Simply stated, a Recognition Agreement is a legal document wherein the cooperative association recognizes the lender as having a security interest in the borrower's unit. It also establishes the steps that either the lender or the coop will take in the event the member/borrower defaults to the lender or to the association. The coop association and the lender, before any loan closing, must mutually agree upon the terms of the Recognition Agreement.

A cooperative association may require that some monies be escrowed at settlement in connection with a Recognition Agreement. This escrow is applied to the loss of any monthly assessment income in the event the lender or the association institutes a foreclosure action against the member/borrower. The amount of escrow varies with each association, but generally the amount ranges from one to three times the member's monthly assessment payment.

A loan on a coop unit is secured by an assignment of the borrower's Ownership or Proprietary Documents to the lender as collateral security for the debt. The lender holds the Proprietary Documents until the loan is paid. The borrower's indebtedness is recorded in the office of the Recorder of Deeds among the chattel or non-land records with the filing of a Uniform Commercial Code Financing Statement (UCC-1).

A loan on real property is secured by a pledge of the owner's deed to the real estate. This pledge is in the form of a Deed of Trust in favor of the lender that is recorded among the land records in the office of the Recorder of Deeds. The unit owner retains actual possession of his or her deed or title to the property even though it has been pledged to secure a debt.

## PART THREE

### Settling A Coop Sale

What does the term “settlement” mean as it applies to a coop sale? Settlement is the act of depositing with the Settlement Officer the purchase monies and such documents that are required to affect a valid transfer of a unit from seller to buyer, and the buyer’s assumption of seller’s obligations under the Ownership or Proprietary Documents. These actions are considered good and sufficient tender of performance.

The Settlement Officer conducts the settlement in accordance with the terms and conditions of the Sales Agreement. All contingencies must be fully satisfied by supporting documentation before settlement can take place, including the requirement that the Board of Directors approve the purchaser for membership and occupancy.

Coop settlements differ from real property settlements in that a coop settlement involves the transfer of personal property. An ownership interest in a coop unit is an interest in personal property, not real estate.

Evidence of ownership in a condominium unit is referred to as fee simple title with an undivided interest in the common elements of the condo association. Ownership in a condominium is represented by a deed. The evidence of ownership in a Cooperative unit, however, is most likely to be represented by a form of cooperative ownership contract or shares of stock and a proprietary lease or some other document commonly referred to as Proprietary Documents.

There are certain economies involved in the transfer of an interest in a coop unit. Since the transfer involves personal property, there is no real estate transfer tax or real estate recordation tax, which is a requirement in most jurisdictions for the transfer of real property. Likewise, except for the Promenade, there is no real estate tax adjustment as is common when conveying real estate.

There is no mechanism among the land records in the Recorder of Deeds Office to record the chain of ownership within a cooperative corporation; hence, there is neither title search fee nor the need to purchase title insurance. On the other hand, the non-land or chattel records on file in the Recorder of Deeds office are searched prior to closing to determine if there are any purchase money liens, tax liens and the like filed against the seller of the coop unit. The buyer pays for the cost to conduct a search of the non-land or chattel records. In addition, the cooperative’s ownership records are reviewed by the Board or by the coop’s Transfer Agent to confirm that the seller is a member of the coop in good standing and the rightful owner of the Proprietary Documents, which the seller is transferring to the buyer.

## **Parties To A Coop Settlement**

Besides the buyer and seller, the cooperative corporation is an important party to the transaction. First of all, the sale is conditioned upon the coop approving the buyer for membership and occupancy. Without formal written approval by the Board, there can be no sale or settlement. Also, by approving the transfer, the cooperative is confirming that the seller is a member of the cooperative and the rightful owner of the unit being transferred. If a lender is involved, the cooperative must agree to enter into a Recognition Agreement with the lender whereby the cooperative recognizes the lender as having a security interest in the unit for which a loan is being made.

## **Application and Approval**

A number of important steps must be taken before settlement can occur. The most important, of course, is that the Board approves the transfer of membership and occupancy. Approval must be in writing, and signed by an officer of the Board.

To obtain board approval, the buyer must make an application to the cooperative for resident membership. Each coop has its own requirements for the sale and transfer of ownership. Typically, an application form seeking information about one's employment status and income, as well as a listing of one's assets and liabilities, is completed.

This information is reviewed by the Board to assess the applicant's ability to handle the monthly carrying costs associated with ownership. Verification of employment, a consumer credit report and letters of personal reference are usually part of the application package. The cooperative may require the seller or buyer to pay a fee for the cost of obtaining a credit report and for handling the review process. Following submission of the application package to management, most coop boards schedule an interview with the buyer to greet the prospective owner, answer any questions and explain some of the more important policies concerning the cooperative's operation.

## **Settlement and Transfer**

In preparation for closing, the settlement officer will initiate a written request to the cooperative's managing agent for a statement concerning the status of the seller's account, as well as verification of the monthly assessment payments allocated against the unit, i.e. the monthly coop fee. The total monthly coop fee covers the unit's share of the cost to operate and maintain the property, including the unit's pro-rata share of the real estate taxes. The monthly fee also includes the principal and interest payment for any corporate mortgage indebtedness, which may be allocated to the unit. Special assessment payments are also verified. All payments are pro-rated according to the terms of the agreement.

In transferring an interest in real property there is no need for the seller to bring his deed to settlement since a title search would have confirmed the seller's ownership interest in the property. It is imperative, however, that the seller of a coop unit bring his original Proprietary Documents to settlement as these are the seller's evidence of ownership, which the seller assigns to the buyer. If the seller is unable to locate his Proprietary Documents, the coop will issue substitute Ownership Documents provided that the seller completes one of the following requirements as dictated by Board policy: (1) provide an affidavit of loss, (2) require the seller to purchase a bond in favor of the coop to indemnify it and the buyer against loss, or (3) initiate a suit for Quiet Title. Both the bond and the suit for Quiet Title are costly measures. The purpose of these actions is to ensure that the seller's ownership interest has not been conveyed or pledged to a third party.

If the Proprietary Documents have been pledged by the seller as collateral security for a note or share loan, then the Proprietary Documents are released by the note holder or lender upon pay-off and returned to the cooperative.

Settlement can be scheduled when the settlement officer has all of the verifications and supporting documents in hand. A settlement statement is prepared which follows in principle the standard HUD-1 form.

At settlement, the seller will assign his right, title and interest in the Proprietary Documents to the buyer. The buyer accepts the assignment and pays the balance of the purchase monies to complete the sale.

Following settlement, the settlement officer must arrange for the President and Secretary of the cooperative to sign and seal the Proprietary Documents, and if there is a purchase money loan involved in the transaction, the Recognition Agreement and related documents. This is usually coordinated through the cooperative's Transfer Agent.

The members of the Board in each and every cooperative are themselves resident owners who volunteer their time. The process of transferring ownership is a reasonable process provided that the policies and procedures established by the cooperative are followed and the Board's involvement in the process is respected.

## **PART FOUR**

### **Brief Description of Cooperative and Condominium Ownership**

The cooperative and condominium forms of ownership are similar in some respects, but there are also some important differences. Most of the similarities are operational in nature while the differences are generally in their legal framework and financing arrangements. Let's take a closer look.

#### **Cooperatives:**

The basis for the cooperative form of ownership is typically found in laws establishing corporations. No special legislation is needed to organize a corporation for the purpose of housing its stockholders/members.

The first cooperative was organized in New York City in the 1880's. In 1920, Edmund J. Flynn in association with Alan E. Walker introduced the first "100% Plan of Cooperative Ownership" to Washington area residents.

Housing cooperatives are owned and operated by the stockholders or member owners. The corporation holds title to the property of which the individual units are a part and each stockholder or member owns a proportionate share of the corporation.

Housing cooperatives are non-profit corporations that are organized either as stock or non-stock corporations. If organized as a stock corporation, each member is a stockholder who receives a stock certificate indicating the number of shares assigned to the unit. The member also receives a proprietary lease granting him/her the exclusive right to occupy a specific unit in the project and to use and enjoy the common elements subject, of course, to the Articles of Incorporation, By-Laws, Rules and Regulations of the cooperative. This right of use and occupancy is appurtenant to, and inseparable from, ownership of an interest in the cooperative entity.

These two instruments, the stock certificate and the proprietary lease, constitute the member's evidence of ownership or "title" to the unit. The member's ownership of the unit is an interest in personal property, not real estate.

Cooperatives organized without capital stock are membership cooperatives. Although still organized as a non-profit corporation, a membership cooperative typically issues a single Ownership Document in place of stock and a proprietary lease. It reflects both the member's ownership interest in the corporation and the member's exclusive and permanent right to occupy the unit and to use the common elements. The evidence of ownership in a membership cooperative varies from one cooperative to another, sometimes called a Cooperative Ownership Contract, Perpetual Use and Equity Contract or a Mutual Ownership Contract. Because of its many forms, the evidence of ownership in a coop is commonly referred to as Proprietary Documents.

A Board of Directors elected by the unit owners to oversee the care, maintenance, operation and administration of the association manages the affairs of the cooperative. The cost to operate a cooperative is proportionately allocated among the unit owners as stipulated in the Articles of Incorporation and/or By-laws.

Loans made to purchasers and owners of cooperative units are secured by a pledge and assignment of the unit owner's Ownership Documents, i.e. Proprietary Documents. The lender holds the borrower's Proprietary Documents as collateral security for the loan. Recording a Uniform Commercial Code Financing Statement (UCC-1) with the Recorder of Deeds, which evidences the borrower's debt on the public records, further perfects the lender's security interest in the Proprietary Documents.

The organizational documents of a cooperative can be structured to serve the financial needs of present and future owners. These associations are referred to as "limited equity" or "low yield" cooperatives in contrast to the more common "market rate" cooperatives. Limited equity cooperatives limit the market value of a unit being sold so that people with low or moderate income can purchase it.

Cooperative ownership provides the same tax benefits as all other forms of home ownership. The tax deductions available to the cooperative corporation, as a result of the payment of real taxes and interest on the corporation's mortgage, are passed through to the individual unit owners in proportion to their ownership interests provided that the coop qualifies under Section 216 of the IRS Code. Briefly stated, if in a particular year more than 20% of the coop's gross income is derived from non-tenant stockholders, it cannot pass through interest and real estate tax deductions to its otherwise qualifying "tenant stockholders" (i.e. the unit owners). Also, interest on an individual unit owner's loan is, likewise, tax deductible.

Each cooperative association has its own policy governing the sale or rental of individually owned units.

The cooperative form of ownership may also be applied to such entities as office buildings, medical centers, mobile home parks as well as commercial business enterprises.

It should be emphasized that in the Washington area, the price quoted for the sale of a cooperative unit is the full price including the unit's pro-rated share of any corporate mortgage financing on the coop's property.

## **Condominiums:**

The basis for the condominium form of ownership is found in state and local law.

Each of the 50 states has laws that enable condominiums to be formed. Sometimes referred to as Horizontal Property Acts, these laws require that a project be declared a condominium and that the legal documents conform to the format stipulated in the state laws.

Condominiums were first legally established in the United States in 1958, when the Commonwealth of Puerto Rico passed a law providing for condominium ownership. Legislation for condominium ownership in the District of Columbia was passed in 1963.

A condominium is a form of ownership in which the individual unit owner owns fee simple title to the unit as well as an undivided interest in the common elements of the condominium, which interest is appurtenant to, and inseparable from, ownership of the unit. The individual's ownership interest is subject to the Declaration, By-laws, Rules and Regulations of the condominium.

Each condominium unit owner is a member of the condominium association. Like a cooperative, the affairs of the condominium association are managed by a Board of Directors elected by the unit owners to oversee the care, maintenance, operation and administration of the association.

The cost to operate a condominium association is proportionally allocated among the unit owners as stipulated in the Declaration and/or By-laws.

Loans made to purchasers and a mortgage or Deed of Trust, which is recorded among the land records in the jurisdiction where the condominium is located, secures owners of a condominium unit. The Deed of Trust is a lien against the unit in favor of the lender who provides the collateral security for the loan.

The condominium unit is always treated as real property for tax purposes and there are no limitations on the owner's ability to deduct interest, real estate taxes and the like.

A condominium association may have some form of policy governing the sale, lease or disposition of individually owned units.

The condominium form of ownership may also be applied to office buildings, industrial parks, medical centers and almost any other form of real property.



## PART FIVE

### Condominium vs. Cooperative

General Characteristics	Cooperative	Condominium
Living Space	<ul style="list-style-type: none"> <li>Owned by cooperative corporation and leased to individual cooperative member (tenant-stockholder)</li> </ul>	<ul style="list-style-type: none"> <li>Separately titled: owned by individual</li> </ul>
Financing	<ul style="list-style-type: none"> <li>Corporate mortgage allocation</li> <li>Unit Share Loan</li> </ul>	<ul style="list-style-type: none"> <li>Unit mortgage</li> </ul>
Collateral	<ul style="list-style-type: none"> <li>Project mortgage—cooperative project (land &amp; improvements)</li> <li>Unit Share Loan-shares and occupancy agreement</li> </ul>	<ul style="list-style-type: none"> <li>Condominium unit and undivided interest in common elements</li> </ul>
Mortgagor	<ul style="list-style-type: none"> <li>Project mortgage—cooperative corporation</li> <li>Unit Share Loan—cooperative member</li> </ul>	<ul style="list-style-type: none"> <li>Unit owner</li> </ul>
Common Areas/Facilities	<ul style="list-style-type: none"> <li>Owned by cooperative corporation</li> </ul>	<ul style="list-style-type: none"> <li>Owned collectively by unit owners as tenants in common, each unit owner having an undivided interest</li> </ul>
Real Estate Taxes	<ul style="list-style-type: none"> <li>Paid by cooperative corporation</li> </ul>	<ul style="list-style-type: none"> <li>Tax on each unit and its undivided interest in the common estate paid by each unit owner</li> </ul>
Basic Documents	<ul style="list-style-type: none"> <li>Articles of Incorporation</li> <li>By-laws</li> <li>Proprietary Documents</li> <li>Special share loan documents (Recognition Agreement, Security Agreement, UCC-1 Financing Statement)</li> </ul>	<ul style="list-style-type: none"> <li>Declaration</li> <li>By-laws</li> <li>Rules and Regulations</li> <li>Unit Deed</li> </ul>
Income Taxes	<ul style="list-style-type: none"> <li>Pass-through deduction to members in cooperative qualified under Section 216 for proportionate share of project mortgage interest and real estate taxes.</li> <li>Direct deduction of unit share loan interest</li> </ul>	<ul style="list-style-type: none"> <li>Direct deduction of unit mortgage interest and real estate taxes</li> </ul>

## **PART SIX**

### **Mr. Flynn's "100% Cooperative Plan"**

Years ago Mr. Flynn wrote that every Washingtonian should become familiar with the details of the "Flynn 100% Cooperative Plan." He stated, "this plan has afforded home ownership to thousands here, who before its introduction, had no hopes or financial reasons of ever owning their own homes or, for one reason or another, did not want the worries and cares of individual home ownership."

The Flynn "100% Cooperative Plan" has been successful in the Washington, D.C. area since its inception in 1920. It has been applied to residential cooperatives including more than 45 well-known and large developments such as the Broadmoor, Hampshire Gardens and Ontario apartments without a single failure, even in the grim Depression years of the 1930's. This is truly a remarkable record that emphasizes the soundness of the Flynn Plan.

It is interesting to note Mr. Flynn's marketing philosophy for the sale of coops in the 1920's, 1930's and 1940's. These early coops were sold on the basis of a substantial down payment, which assured the purchaser a markedly lower-than-rent monthly outlay for combined purchase payments and maintenance costs. By having monthly purchase payments less than rent, monthly payments did not put a strain on the pocket book. Mr. Flynn wrote that this arrangement "means extra income during good times...permits you to maintain a comfortable home during any depressed economic period. The low down payment method of financing, with its obvious reliance on never-ending prosperity, has no place in the Edmund J. Flynn '100% Cooperative Plan'." This is an admittedly conservative, yet, prudent approach.

### **What is Meant by "100% Cooperative?"**

"100% Cooperative" means that the coop association will commence business with full membership, that is, a responsible owner for every cooperative unit. Prices are assigned and costs allocated based on a value relationship of each individual unit to the value of the apartment building as a whole. Mr. Flynn's plan also differed from many other so-called cooperatives at the time because the association could operate as a non-profit enterprise without any dependence on speculative income from commercial rentals in order to remain solvent.

### **Is a Cooperative Buyer a Real Owner?**

Yes, under this cooperative plan, “an owner of a commercial or residential unit in a Flynn cooperative building will own his space in perpetuity...will enjoy every prerogative of an individual owner that is consistent with a well-organized mutual ownership enterprise... will have the privilege to sub-lease, sell, transfer, or pledge his ownership interest at any time, subject only to the necessary safeguard that occupancy rights cannot be transferred without approval of the association of cooperative owners. “Therefore’ the owner of a cooperative unit under this plan will have the maximum incidents of outright individual ownership.”

### **Are Prices Quoted “Equity Value” Prices or is “Full Cost” Included?**

Many cooperative plans quote only the “equity” or “down payment” as the price of the unit. But doesn’t the allocated corporate mortgage add to the total cost of the unit? Mr. Flynn wrote that “it would be pure deception to attempt to make the purchaser of a house believe that his mortgage was not included in the price he was paying for it. A buyer of a cooperative unit is entitled to the same treatment. Under the Flynn Plan, the price quoted to a prospective buyer includes the share of corporate mortgage allocated to the unit.” To this day, all coop sales in the D.C. metropolitan area follow this pricing principle.

## **PART SEVEN**

### **Why Condos Became Popular**

If coops are such a sound and sensible form of ownership, why aren't there more coops being organized and sold? Coops continue to be organized and are typically located in densely populated urban areas. On the East Coast, New York City has the greatest number of coops followed by Washington, D.C. Unlike condominiums, no special legislation is required for a group to form a corporation and purchase a rental apartment building in the name of the cooperative housing corporation.

Nevertheless, why are condominiums more popular? The answer can be summed up in one word: financing. Edmund J. Flynn first organized coops in Washington in 1920. For nearly 60 years thereafter, bank financing was not available to purchasers of coop units. Banks in the District of Columbia are organized under Federal Charter and federally chartered banks were not permitted to loan money secured by a pledge of one's ownership interest in a coop. Coop purchasers had to pay cash for their unit or the seller had to take back a note for part of the cash requirement.

The lack of bank financing adversely affected coop ownership in two ways. First of all, it made coops difficult to sell; second, it suppressed the value of coops. Just think of what today's real estate market would be if buyers could not finance their purchases.

In 1979, an important event took place that would ultimately improve the marketability of cooperatives. On August 2, 1979, the Federal Home Loan Bank Board (FHLBB) issued its final regulation authorizing federal savings and loan associations to make loans on individual cooperative units in accordance with the rules governing loans on single-family dwellings and to otherwise amend its rules to provide similarity of treatment between coop loans and other home loans. The effective date of the new regulation was September 6, 1979.

The new rule allows loans up to 95% of the appraised value of the cooperative unit, less the allocated portion of the corporate mortgage.

Loans in excess of 80% have to be insured according to other FHLBB regulations. Therefore, as of September 6, 1979 federal savings and loan associations were permitted to make loans on individual cooperative units to be secured by an assignment of the borrower's Proprietary Documents to the lender. For insured or guaranteed loans, such loans may be made on any terms acceptable to the guaranteeing or insuring agency.

Banks were slow to tap the potential of this new lending opportunity. More importantly, bank managers were generally resistant to involve their institution in making loans collateralized by personal property. And yet, at the time, these same banks were aggressively marketing other loans secured by personal property of diminishing value, i.e. car loans, boat loans, and the like.

About the time when sources of bank financing for coop resales were gaining momentum, enabling legislation for condominium ownership was enacted. In D.C., the year was 1963. Even though condominiums were not real estate in the traditional sense (i.e. land) the enabling legislation said they were. As “real estate,” condos soon found favor among bankers, developers and consumers.

## **PART EIGHT**

### **Why Oh Why Should I Favor Coops?**

As a form of multi-family ownership, coops offer several distinct advantages. A few of the more significant advantages are highlighted.

First of all, title to the land is in the name of the housing corporation. This is significant because the corporation has a mortgageable asset. For example, if there were a need to fund a costly capital improvement, the membership could decide to fund the cost by placing a mortgage on the property resulting in small payments every month over time as opposed to one or more special assessments. Condominium associations have no "property" or equity to mortgage for long term financing.

Second, most delinquencies and other problem matters can be handled administratively, thereby avoiding costly and time-consuming legal action.

Thirdly, the membership can establish policies to control the owner/investor ratio within the association. A rental policy can be established to insure that the number of investor-owned units does not exceed the secondary market requirements for First Trust financing. Furthermore, the real estate tax rate on the coop's property in the District of Columbia is likewise affected by the owner/investor ratio. Depending on the organizational structure of the condominium when first established, the condominium board would have legal difficulty in restricting an owner's right to rent.

There are other advantages as well. One obvious benefit is the cost to settle a coop purchase. The cost is modest when compared to buying a condo. There is, at present, no transfer or recordation tax, no real estate tax proration, no title insurance, ergo, no title search.

Another obvious benefit is the relative simplicity in organizing a coop. For example, to convert an existing rental building from an investor-owned rental property to property owned by a coop association involves only a change in ownership. Simply stated, the property as a whole is conveyed from the seller of the apartment building to the cooperative corporation. The property does not have to be subdivided into individual lots in the case of a condo conversion, which reduces the cost to convert.

Coops are taxed more like rental buildings. There is one tax bill. The bill for a coop corporation is typically much less than the taxes in the aggregate for the unit owners in a condo. A contributing factor is that coop sales are not recorded.

A more subtle benefit is the incidences of delinquencies in a coop. Delinquencies are minimized as a result of the application process. Typically, coops require prospective owners to apply for resident membership. This includes a statement of income, assets and liabilities, a credit report and the like. The process of having one's financial status reviewed by the Board (i.e. future co-owners) discourages applicants with questionable credit. The coop relies on the membership to meet its financial obligations, which include, among other obligations, real estate taxes and the monthly payment on its corporate mortgage. Therefore, the credit worthiness of a prospective member is vital to the financial well being of the association. This process minimizes delinquencies. Lenders are quick to state that coop borrowers, as a group, are reliable payers and that foreclosures are nearly non-existent.

The Edmund J. Flynn Company has been true to its heritage by being a constant and dedicated promoter of cooperative housing since Mr. Flynn first introduced coops to Washington in 1920. Most of Washington's "Best Addresses"\* are coops. This is a convincing testimony to the fact that coops are a viable and proven form of ownership.

May there be a coop in your future!

*\*Best Addresses: A Century of Washington's Distinguished Apartment Houses. Goode, James M. Smithsonian Institution: 1988.*